

Good afternoon. On behalf of Vice Chairman Ellen Williams and Commissioner Greg Coker, I want to thank you for allowing the Kentucky Public Service Commission to be a part of this important event. I look forward especially to hearing the thoughts of my fellow panelists, whose expertise I find a bit humbling.

Coal is woven as tightly into the economic, social and historic fabric of our Commonwealth as any other aspect of Kentucky – be it racehorses, bourbon or burley tobacco. So there is no question about the importance of the topic we address today – the future of the coal industry over the next 15 years.

I have been a utility regulator for only eight months. But I have grown up with coal.

My ancestors came to Harlan County, Kentucky, more than two centuries ago, long before Harlan became almost synonymous with Appalachian coal. Although my family was not in the coal business – I'm a fourth-generation country lawyer – for the last century, our lives have been intertwined with the coal industry.

I have represented hundreds of coal miners. My father represented coal miners. So did my grandfather and great-grandfather. They were – and are – our friends and neighbors.

Names of coal companies: Blue Diamond, Peabody, United States steel, International Harvester and coal camps: Yancey, Liggett, Brookside, Chevrolet and Benham – are in my native vocabulary.

And, as anyone who grew up in the coalfields can tell you, every aspect of life in a town like Harlan is intimately connected to life in the mines. When the industry prospers, we all do well. When it suffers, we all share its pain.

So my interest in today's topic is not just that of someone who regulates companies that rely on coal as a fuel. It is a deep and abiding personal interest that encompasses both my family's past and the future of my community.

One of the first things I learned when I came to the PSC is that every member of the Commission is entitled to – and, in fact, expected to – brag about one salient fact – Kentucky consistently has among the lowest average electric rates in the country. On average, Kentucky consumers pay about 4.3 cents for each kilowatt-hour of electricity they consume. Those low costs have been a huge factor in driving economic development in our state.

While it is tempting to simply attribute the low rates to the brilliant work done by the PSC, the reality is that those rates are built on coal. On average, coal is used to generate about 90 to 95 percent of the electricity used in Kentucky.

Kentucky is the third-largest coal producing state in the country, trailing only Wyoming and West Virginia. Production in 2002 was 124 million tons.

Consumption that year was 41 million tons, the vast majority of it used in electric generation. And Kentucky still has almost 30 billion tons of recoverable reserves.

About sixty percent of the electricity generated in Kentucky is produced by burning Kentucky coal. For environmental, operational and economic reasons, the rest comes from other states, the vast majority of it from West Virginia, with smaller shares from other neighboring states and some from as far away as Colorado and Wyoming.

That coal is consumed in 22 power plants, ranging in capacity from 75 megawatts to 2,558 megawatts.

While those plants represent only about three-fourths of Kentucky's generating capacity, they produce, as I've noted earlier, better than 90 percent of our electricity, and at very low cost.

Furthermore, Kentucky has been able to sustain coal-fired generation and low-cost electricity while doing more than most states to protect the environment. In the eastern half of the nation, Kentucky leads the way in the percentage of generating capacity that is equipped with scrubbers to remove sulfur dioxide. And that percentage is climbing.

Kentucky utilities are also moving quickly to add equipment to remove nitrogen oxides from their exhaust streams.

So what we have in Kentucky is a utility industry that produces low-cost electricity by burning coal while doing it in an environmentally sound manner. I can assure you that this combination did not occur accidentally. It is the result of sound public policy.

After all, the use of coal in electric generation has faced significant challenges in recent years. Both coal mining and coal combustion have been subjected to stringent environmental regulations that have increased the cost of utilization. And, like any other fossil fuel, coal has been subject to price fluctuations that have led to market disruptions.

Kentucky has developed policy solutions that enable power producers to deal with both of those challenges.

Let me turn first to environmental compliance costs. In 1992, in response to the federal Clean Air Amendments, the Kentucky General Assembly established a mechanism for electric utilities to recover their environmental compliance costs without having to go through the complex – and often contentious, as we have seen recently – process of general rate adjustment. The environmental surcharge mechanism gives utilities the assurance that they will fully recover the capital and operating costs associated with environmental compliance. This mechanism has enabled utilities to make the

investments needed to continue burning coal – including high-sulfur Kentucky coal – while meeting today's more stringent environmental requirements.

I also should note that some of our utilities built scrubbers and other pollution-control devices long before they were required to by federal law. The fact that they long ago recovered the cost of those investments also has contributed to Kentucky's low rates.

While coal prices don't fluctuate as wildly as some other energy prices – and certainly don't get the attention generated by those 20-cents-a-gallon jumps at the local gasoline station – they still are prone to dramatic changes. For example, the spot price of Central Appalachian coal was about \$30 per ton two years ago. Today it is over \$60 per ton.

As you know, that kind of price volatility poses problems for producers and consumers alike, creating supply disruptions and the potential for significant economic losses.

To buffer utilities against the price volatility, Kentucky created the fuel adjustment clause. It permits utilities to adjust electric rates – again without going through general ratemaking – to reflect changes in fuel prices. When fuel costs increase above a benchmark level, utilities impose a surcharge. When fuel costs fall below the benchmark, customers receive a credit. The adjustments are subject to periodic review by the PSC.

As long as utilities make a good-faith effort to obtain fuel at the lowest possible prices, they are assured of recovering of their fuel costs within a reasonable time frame.

With both the environmental cost recovery and fuel adjustment clause mechanism firmly established in Kentucky's regulatory framework, I believe that coal will remain the dominant fuel for electric generation in Kentucky.

There is other ample evidence to support that conclusion. For example, look at what has happened with the merchant power industry.

In 2001, there were about 20 merchant power plants in some stage of development in Kentucky. Only seven were coal-using projects; the rest were going to run on natural gas.

Three of those plants – all of them natural gas turbine facilities – were under construction when former Gov. Patton imposed a moratorium on new power plant construction until the state could assess the potential impact of all that new generating capacity on our electric transmission grid, our environment and our economy. Out of that moratorium came legislation establishing a Siting Board to review merchant power plant proposals. As chairman of the PSC, I also sit as chairman of the Siting Board.

The moratorium lasted a little more than a year. The Siting Board has been in business for two and a half years. Thus far, it has received only four applications. All of them propose to use coal in some form; not one is for a facility using natural gas.

Briefly, the four proposed plants are:

1. Kentucky Mountain Power, a 500-megawatt facility in Knott County that would use a mix of coal and coal wastes in a pair of fluidized bed boilers. It was approved nearly two years ago. The latest information we have is that some site preparation is underway.
2. Thoroughbred Generation, a 1500-megawatt pulverized coal plant in Muhlenberg County. It was approved late last year, subject to the resolution of some issues relating to transmission interconnections.
3. Kentucky Pioneer, a 540-megawatt facility in Clark County, also received conditional approval last year. As originally proposed, it was to gasify a combination of pelletized solid waste and coal. That was later changed to coal. While the process originally appeared promising, it now appears unlikely that the project is going to move forward anytime soon.
4. Estill County Energy Partners is a 110-megawatt fluidized bed combustion plant that proposes to use mostly waste coal from a former coal processing plant. An order granting conditional approval was issued today.

In sum, what we are seeing in the merchant power industry in Kentucky seems to be a vote of confidence in the future of coal for baseload generation.

A similar vote is also being cast by our regulated utilities. While the regulated utilities in Kentucky have added considerable gas-fired peaking capacity in recent years – and have plans to add some more – they continue to look to coal to meet the growth in baseload demand.

East Kentucky Power is well on the way to completing a 270-megawatt unit at its Spurlock facility, and recently announced that it will seek a certificate for another such unit.

Louisville Gas & Electric has signaled its intention to add a second coal-fired unit at its Trimble County plant. At 732 megawatts, it would more than double the baseload capacity at Trimble.

All of that tells me that the immediate future of coal is bright in Kentucky.

And about those gas-fired merchant plants. One is in mothballs and the others are said to be for sale.

Let me turn briefly now to some of the future technologies that I believe could ensure that coal retains its preeminent status for many decades to come.

Coal gasification is likely to be the first of those to have a major impact. As an established technology that reduces emissions of all major combustion gases, including carbon dioxide, it has the potential to allow coal to be utilized with even more stringent air emission control requirements than those we have now.

Farther in the future is the next generation of power plants, exemplified by the US Department of Energy's Vision 21 project. It has set the ambitious goal of developing a power plant that would utilize coal at 60 percent efficiency, produce virtually no air and water emissions and, if used with carbon sequestration, produce no carbon dioxide. Certainly, the successful development and deployment of advanced technologies such as this could ensure that coal remains a fuel of choice into the next century.

Finally, there is the promise of new transmission technology, which holds out the promise of moving large quantities of electricity over long distances with very small line losses. While reducing transmission losses does reduce the need for generating capacity and hence fuel, it also holds out the promise of coal-by-wire – allowing states such as Kentucky to add value to their natural resources by shipping electrons rather than coal,

My fellow commissioners and I are going to be following these developments very closely. Our current regulatory framework has served Kentucky well – you really can't argue with low rates, robust and reliable infrastructure and financially healthy utilities.

As circumstances and technologies change, we may have to make some adjustments. But I can't imagine that we will ever stray from the PSC's mission to ensure that Kentucky's regulated utilities provide safe and reliable service at just and reasonable rates.

Kentucky has a long, complicated and sometimes contentious relationship with its coal industry. (I grew up hearing stories about the contentious part.)

Our state's coal industry has undergone some significant changes in the last three or four decades. But it has remained at the core of our economy and of our collective psyche. I see no reason for that to change in the next 15 years.

I thank you again for the opportunity to be with you today and I look forward to hearing your ideas and suggestions for how we can maintain Kentucky's record of success.